CalPERS
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3400

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AGENDA ITEM 5a

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

I. SUBJECT: Revision of Policy on Internally Managed Global Equity Index Funds

II. PROGRAM: Global Equity

III. RECOMMENDATION: Recommend to the Investment Committee approval of the revised Statement of Investment Policy for Internally Managed Global Equity Index Funds

IV. ANALYSIS:

Background

This item recommends revision of the Policy on Internally Managed Global Equity Index Funds to both remove Argentina from the emerging markets benchmark as well as to expand the application and improve the efficacy of the Dynamic Completion Fund (DCF) program.

The proposed revised Policy is included as Attachment 1. The revised Policy is presented as a black-lined version from the last adopted policy by the Investment Committee. The black line uses strike-out to indicate the deletions and double underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Wilshire's opinion letter is included as Attachment 2.

Changes to Emerging Markets Benchmark

In a previous memo to the Investment Committee dated October 22, 2008, Staff described the rationale for removing Argentina from the emerging equity markets benchmark. The main rationale was that the Argentine government had proposed legislation to take control of the country's private pension system made up of 10 funds with some $29.3 billion in assets. This action was believed to be caused by the country's inability to service its outstanding debt and was seen as a precursor to a likely default. These activities were viewed as extremely negative for the local stock market as it was perceived that the government could potentially direct the sale of equity positions to provide capital for government bond purchases.

As a result, Staff was granted approval to liquidate all Argentine equity holdings (which was completed by the end of October) and to move forward with removing Argentina from the emerging markets benchmark. To implement this benchmark change, Staff recommends one revision to policy section IV.B.5.

Changes to the DCF Structure

Historically, Internal Equity has managed a Dynamic Completion Fund (DCF) designed to complete any benchmark misfit exposure resulting from external active managers having benchmarks that differ from CalPERS' strategic benchmark. This fund, however, has been exclusively U.S. domestic in nature and has "completed" only the external manager program.

As a result of the expansion of both the internally managed equity program as well as CalPERS' international equity program, there have become an increasing number of portfolios that are managed to benchmarks that differ from CalPERS' strategic Global Equity benchmark. As such, a policy revision is needed that incorporates two changes for the existing DCF program:

1. Expanding the DCF program to incorporate not only externally managed portfolios but also those that are internally managed.

2. Broadening the DCF program to "complete" not only U.S. domestic equity exposure but also international equity.

As a result of the policy revision, the benchmark and thereby management of the DCF will be updated to address both internally managed and externally managed portfolios. On an ongoing basis, Staff will continue to monitor the international equity benchmark misfit as a result of the portfolios managed both internally and externally. During the transition to a more global capitalization weighted benchmark, an international version of the DCF is not needed. If an international version is determined to be needed after the transition, Investment Committee approval will be attained before the launch of any such portfolio.

V. STRATEGIC PLAN:

This item is consistent with the Strategic Plan: Goal VIII, manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second to minimize and stabilize contributions.

VI. RESULTS/COSTS:

There are no material costs associated with this agenda item.

Daniel Bienvenue
Senior Portfolio Manager
Internal Equity

Eric Baggesen
Senior Investment Officer
Global Equity

Anne Stausboll
Interim Chief Investment Officer